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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

NO. 78-595

LONE STAR GAS COMPANY, a division of Enserch Corporation, *Petitioner*,

v.

BOB BULLOCK, Comptroller of Public Accounts, JESSE JAMES, State Treasurer, JOHN HILL, Attorney General, and THE STATE OF TEXAS, *Respondents*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF TEXAS

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF TEXAS

Lone Star Gas Company, petitions for a Writ of Certiorari to review the judgment of the Supreme Court of Texas.

OPINIONS

The opinion of the Supreme Court of Texas (Appendix A) is reported at ____S.W.2d____. The opinion of the Court of Civil Appeals for the Tenth Supreme Judicial District (Appendix B) is reported at 558 S.W.2d 566. The decision of the 53rd Judicial District Court of Travis County, Texas (Appendix C) is unreported. The decision of the Comptroller of Public Accounts on Petitioner's Claim for Refund (Appendix D) is unreported.

JURISDICTION

The opinion of the Supreme Court of Texas was entered on June 7, 1978, and made final by order overruling motion for rehearing entered on July 12, 1978. The jurisdiction of this Court is timely invoked under 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

1. Whether state taxing officials may, consistent with the Fourteenth Amendment:
   a. promulgate, during the pendency of this suit for tax refund, a regulation legitimizing their position in the lawsuit (reversing earlier regulations favorable to Petitioner) and thus secure a judgment denying a refund based on the retroactive application of the new regulation; and
   b. retroactively apply the new regulation only against the Petitioner while admittedly permitting the Petitioner's competitors to receive tax refunds on identical transactions during the same time period.
2. Whether the interpretation of Article 20.04(G)(3)(a) by the Supreme Court of Texas so that only taxpayers purchasing goods outside the State of Texas will be taxed, unduly burdens interstate commerce?

STATUTES INVOLVED

This case involves consideration of the following constitutional provisions and statutes (the texts of which are set forth in Appendix E) Article I, § 8, Cl. 3, Constitution of the United States; Fifth Amendment, United States Constitution; Fourteenth Amendment, United States Constitution; Articles 20.02, 20.03, and 20.04, Texas Limited Sales, Use and Excise Tax Act; and Article 1066c, Tex. Rev. Civ. Stat. Anno., Comptroller's Rulings No. 95-0.14, 026.02.20.017, and 026.02.20.020.

STATEMENT OF THE CASE

This petition arises from the assessment of State of Texas sales taxes by Respondent Bullock against Petitioner.

In 1973, Petitioner purchased in Europe 232 miles of specially manufactured gas line pipe. The pipe was shipped into the State of Texas through the Port of Houston, Texas, and incorporated into a 400 mile long gas pipeline located in West Texas. Petitioner, assuming that the sale was consummated outside the taxing jurisdiction of the Texas sales tax act, Article 20.02, reported and paid a four percent State of Texas *use* tax under Article 20.03 on the pipe when it was placed in service as part of the pipeline.[1]

The Respondent Bullock audited Petitioner's tax returns for the reporting quarters involved and assessed an additional one percent City of Houston sales tax under the provisions of Article 1066c, Tex. Rev. Civ. Stat. Anno. on the pipe. The Respondent claimed that the sale of the pipe had occurred at the Port of Houston, Texas, and that both state and city *sales* taxes were due on the transaction. A credit was allowed for the state *use* tax

1. Like most states which have enacted a sales tax applicable to sales transactions within the territorial limits of the state, Texas has enacted a compensating use tax to protect its merchants from out of state competitors whose prices do not reflect the sales tax. The Texas use tax generally applies to nonexempt items purchased outside the state on which no sales or use tax has previously been paid. Articles 20.03, 20.04(J) and 20.04(K). *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1936).

previously reported and paid by Petitioner.[2] The Petitioner claimed that the sale had occurred in Europe and that the first use of the pipe had occurred outside of the City of Houston. An administrative hearing was held, and Respondent declined to refund or abate the sales tax assessments. The administrative decision (Exhibit D) concluded that the pipe could not be subject to the use tax because of the exemption provided by Article 20.04 (G)(3)(a), and stated:

> "V.A.T.S., Tax.-Gen., art. 20.04(G)(3)(2) [sic] provides:
>
> "(3) Special Use Tax Exemption. The use tax imposed herein shall not apply to:
>
> "(2) [sic] The use, in this State, of tangible personal property which is acquired outside this State and which is moved into this State for use as a licensed and certificated carrier of persons or property . . .
>
> "Petitioner is certificated by the Railroad Commission at Texas to operate a pipeline. A certificated pipeline is recognized as a common carrier. *Explorer Pipeline Company v. Calvert,* 126th Judicial District Court, No. 193,423, Austin, Texas, December, 1972. *Therefore, if the sale of pipe is not subject to the sales tax, it is not taxable.*" [Emphasis added] *In Re: Lone Star Gas Company* Comptroller of Public Accounts of the State of Texas, Hearing No. 6759 (August 29, 1975).

Pretrial discovery revealed that the Respondent Bullock had followed an administrative policy of refunding *use* taxes to taxpayers who purchased pipe outside the State

2. The sales and use tax rates are the same so no deficiency in state taxes was occassioned by reclassification of the tax due from use to sales.

of Texas. Included in this group were Petitioners competitors. The sole basis for denying Petitioner's claim for refund was the Respondent's contention that the sale of the pipe had occurred at the Port of Houston so that sales taxes were due even though the pipe was exempt from the use tax under Respondent's interpretation of the statute.

On September 1, 1975, Respondent Bullock issued a formal ruling[3] (Ruling No. 95-0.14, Appendix E) embodying prior departmental policy that taxpayers like Petitioner were entitled to exemption from the use tax for out-of-state purchases of pipe. On November 21, 1975, Petitioner instituted this suit for refund of its sales taxes, claiming that the pipe had been purchased in Europe, and claiming that no use tax was due under the Comptroller's September 15th ruling. On December 31, 1975, the Respondent issued a new ruling (Ruling No. 026.02.20.017, Appendix E) which revoked his ruling of September 1, 1975, and announced that pipeline carriers would not be allowed a use tax exemption. At the trial of this case, Respondent John Hill announced that the December 31, 1975, ruling would be applied to Petitioner with regard to the use tax and argued, alternatively, that the *sales* tax was properly collected from Petitioner. Petitioner timely objected that it was being discriminated against in view of the prior refunds of use taxes to its competitors. The trial court held that the purchase of pipe had occurred in Europe (thus re-

3. Although denominated as rulings by the Respondent, the interpretations issued by him have an *a priori* character similar to regulations issued by the Secretary of the Treasury under the federal tax statutes, rather than the *ad hoc* character of Revenue Rulings issued by the Commissioner of Internal Revenue. The words ruling and regulation are used interchangebly herein.

moving the transaction from the coverage of the sales tax) and rejected the application of Respondent's post hoc regulation regarding the use tax. It entered judgment for Petitioner in the amount of $809,102.52 plus interest. The intermediate appellate court affirmed, without reaching Petitioner's Fourteenth Amendment claims. The Supreme Court of Texas reversed and rendered judgment against Petitioner, adopting the rationale of the December 31, 1975 ruling despite the questionable timing of its issuance and without comment on the discriminatory treatment of Petitioner.

REASONS FOR GRANTING THE WRIT

Question One:

Whether State Taxing Officials May, Consistent With The Fourteenth Amendment:

a. **Promulgate, During The Pendency Of This Suit For Tax Refund, A Regulation Legitimizing Their Position In The Lawsuit (Reversing Earlier Regulations Favorable To Petitioner) And Thus Secure A Judgment Denying A Refund Based On The Retroactive Application Of The New Regulation; and**

b. **Retroactively Apply The New Regulation Only Against The Petitioner While Admittedly Permitting The Petitioner's Competitors To Receive Tax Refunds On Identical Transactions During The Same Time Period.**

The Petitioner was denied due process of law by the actions of Respondents Hill and Bullock. Respondent

Bullock revoked prior published regulations applying the use tax exemption to Petitioner after this suit was commenced, and issued a new regulation tailor made for his defense of Petitioner's suit for refund. The federal courts have recognized that the promulgation of retroactive regulations tailor made for litigation can offend the due process clause of the Fifth Amendment. *Anderson Clayton & Company v. United States,* 562 F.2d 972, 980-81 (5th Cir. 1977); *Chock Full O'Nuts Corp. v. United States,* 463 F.2d 300, 302-03 (2nd Cir. 1971); *Commissioner v. Goodwyn Crockery Co.,* 315 F.2d 110, 113 (6th Cir. 1963). While this Court has given limited approval to retroactive rulings by the Commissioner of Internal Revenue, *Dixon v. United States,* 381 U.S. 68 (1965), it has not considered the application of the Fourteenth Amendment due process protection to the actions of state officials, and the lower federal courts have created limitations on the permissible retroactivity of federal tax regulations under the Fifth Amendment Due Process clause, by extending the rationale of *Dixon* without further guidance from this Court.

This case squarely presents the question left unanswered by *Dixon* and *Automobile Club of Michigan v. Commissioner,* 353 U.S. 180 (1957), i.e., whether the due process requirements of the Fifth and Fourteenth Amendments provide taxpayers any protection from retroactive revocation of settled administrative interpretations of a taxing statute. It presents this Court with a unique opportunity to elaborate upon its prior decisions, to provide guidance to both state and federal courts concerning the proper standards of review of state and federal tax administration, and to examine the current development

by the Court of Claims and the Second, Fifth, Sixth and Eighth Circuit Courts of Appeals of the limitations imposed by the due process clause upon retroactive regulations.

Petitioner is entitled to relief from the retroactive application of the December 31 regulation. Respondent Bullock ruled, in his administrative decision on Petitioner's claim for refund, that Petitioner was within the scope of the exemption. It was only after Petitioner filed this suit to recover its sales taxes that Respondent changed his position retroactively to vindicate collection of use taxes on the pipe. This is precisely the behavior which the Court of Appeals for the Second Circuit found to be questionable as an abuse of administrative process in *Chock Full O'Nuts*:

> "To the extent that a regulation interprets or elucidates the meaning of a statute, it is merely explanatory or confirmatory rather than retroactive. A taxpayer, when acting in an area of unsettled law, has no 'vested interest in a hypothetical decision in his favor prior to the advent of the regulations.' *Helvering v. Reynolds,* 313 U.S. 428, 433, 61 S.Ct. 971, 974, 85 L.Ed. 1438 (1941). On the other hand, *the Commissioner may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded such regulations.*" 453 F.2d 303 (footnotes omitted, emphasis added).

This is not a case where a taxpayer knowingly elected to accept the risk of a change in unsettled administrative policy. The Respondent himself stated that "if the sale

of pipe is not subject to the sales tax, it [the pipe] is not taxable" *In re: Lone Star Gas Company, supra;* and gave every indication throughout the administrative process that the law was settled, and that the exemption applied to Petitioner. Only after Petitioner instituted this action did Respondent change the law to legitimize the taxes which had already been collected.

The questionable purpose of the Respondent's retroactive application of the December 31 regulation to the Petitioner is further illustrated by the admitted fact that it was applied retroactively only against the Petitioner. Respondent Bullock admitted in response to Petitioner's Requests for Admission during discovery that use taxes had been refunded to other taxpayers who imported large petroleum pipe into Texas. Even if the retroactive application of the regulation is permissible as a general proposition, surely fundamental principles of due process and equal protection require that it be applied to all similarly situated taxpayers.

Standing alone, the fact that Petitioner's competitors received refunds of use taxes paid in the same period on similar transactions is sufficient grounds for relief. *International Business Machines Corp. v. United States,* 343 F.2d 914 (Ct. Cl. 1965). The Comptroller's decision to enforce a regulation retroactively is not without limits; it must be a rational one supported by relevant considerations. 343 F.2d at 920. No considerations supporting retroactive application only to Petitioner have been suggested here. When coupled with the fact that the December 31, 1975, regulation reversed what had appeared to be settled administrative policy, retroactivity is a denial of due process. *Anderson Clayton & Co. v. United States,* 562 F.2d 972, 981 (5th Cir. 1977).

The fact that the new regulation has been applied retroactively to only one taxpayer raises obvious equal protection problems. Respondent has not evidenced any intent to attempt to collect the previously refunded taxes from Petitioner's competitors. Respondent has apparently singled Petitioner out as the one taxpayer against whom to apply the new regulation retroactively. *See, Morey v. Doud,* 354 U.S. 457 (1957) where this court held that legislation singling out a single business by name for favorable treatment was offensive to the equal protection guarantee even though supported by rational considerations. *See also, Weissinger v. Boswell,* 330 F.Supp. 615 (M.D. Ala. 1971).

Thus, it is respectfully suggested that the selective retroactive enforcement of the December 31, 1975 regulation after the commencement of this proceeding violated both the due process and the equal protection provisions of the Fourteenth Amendment and requires relief from this Honorable Court.

Question Two:

Whether The Interpretation Of Article 20.04(G)(3)(a) By The Supreme Court Of Texas So That Only Taxpayers Purchasing Goods Outside The State Of Texas Will Be Taxed, Unduly Burdens Interstate Commerce?

Even if the December 31, 1975, regulation may be retroactively applied to Petitioner, the regulation places an impermissible burden on interstate commerce. The regulation operates to tax only those taxpayers who purchase pipe from sources outside the State of Texas and

import it for assembly into a pipeline. Taxpayers who purchase pipe within the state will not be subjected to the sale or use tax. In the context of the entire Texas Sales and Use Tax Act, the regulation, as now construed by the Supreme Court of Texas, only operates to tax purchasers who engage in interstate commerce.

This case is ruled by this Court's opinion in *Halliburton Oil Well Cementing Co. v. Reily,* 373 U.S. 64 (1963). In *Halliburton,* this Court held unconstitutional under the commerce clause a Louisiana sales and use tax scheme which operated to impose a substantially higher tax on interstate companies which manufactured equipment for their own use. The taxpayer in that case maintained fabrication facilities in Oklahoma where it assembled equipment for use in Louisiana. The Louisiana taxing authorities imposed a use tax on the full value of the assembled equipment, including the taxpayer's labor charges, while admitting that only materials cost would have been taxed if the equipment had been assembled in Louisiana. This Court held that even though the inequality of treatment might be merely an accident of statutory drafting, its practical effect was to violate a condition precedent for taxation of interstate business, i.e., equal treatment for in-state and out-of-state taxpayers similarly situated. 373 U.S. at 72.

The interaction of the Texas statutes, administrative rulings, and the opinion of the Supreme Court of Texas in this case, has the same effect found impermissible in *Halliburton.* The Respondent Bullock has issued a Ruling, No. 026.02.20.020, which holds that property purchased for fabrication into a finished product is exempt from taxation until it is put to a non-exempt use. This Ruling

would apply to pipe purchased in Texas until it is assembled into a pipeline, at which time the pipeline itself would be exempt under the intermediate appellate court's decision in this case because the pipeline is a "licensed and certificated carrier" exempt under Article 20.04(G)(3)(a). Thus, the in-state purchaser of pipe would be exempt from both sales and use taxes.

In this case, the Supreme Court of Texas held that Petitioner's pipe was properly subjected to taxation because it was stored in Texas prior to its use as a licensed and certificated carrier of property exempted by Article 20.04(G)(3)(a). The language of the opinion indicates that any cessation of movement, no matter how brief, will subject the imported pipe to taxation. The record in this case indicates that Petitioner made every effort to maintain the continuous movement of its pipe, but the Supreme Court of Texas found that a taxable storage had occurred. The practical effect of the opinion of the Supreme Court of Texas is that out-of-state purchasers of pipe for assembly into a gas pipeline will pay taxes, while in-state purchasers of pipe for assembly into a gas pipeline will not under the Comptroller's Ruling.

Regardless of the intent of the statute, through interpretation it discriminates against interstate commerce. Taxpayers, like Petitioner, can only avoid taxation by foregoing the economic advantages of purchasing pipe out of state.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Michael L. Cook, certify that three true and correct copies of the foregoing Petition for a Writ of Certiorari were served upon Ms. Martha Smiley, Assistant Attorney General, Office of the Attorney General, Post Office Box 12548, Capitol Station, Austin, Texas 78711, attorney for Respondents herein, by placing same in the United States Mail, Certified Mail, Return Receipt Requested, on this _____ day of October, 1978.

MICHAEL L. COOK

APPENDIX A

IN THE SUPREME COURT OF TEXAS

NO. B-7311

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS, ET AL.,
Petitioners,

v.

LONE STAR GAS COMPANY,
Respondent.

From Travis County

Tenth District

Lone Star Gas Company instituted this suit to obtain a refund of state and local sales and use taxes paid on pipe imported from Europe and laid in a Lone Star Gas pipeline used by Lone Star in the intrastate sale and distribution of gas in Texas. The trial court, after a non-jury trial, rendered judgment for Lone Star and ordered a refund of the taxes with interest. On appeal by the State, the Court of Civil Appeals affirmed the judgment. 558 S.W.2d 566. We reverse those judgments and render judgment that Lone Star take nothing in its suit.

In early 1972, Lone Star embarked upon the construction of a 400 mile pipeline from Coyonosa in Pecos County, Texas, to Cedar Hill in Dallas County, Texas. The pipeline was designated Line X and was designed to bring natural gas from the Delaware Basin production field to the Dallas area. It was the purpose of Lone Star

to complete at least a portion of the line during 1972 in order to reduce its federal tax liability. Lone Star also desired to avail itself of the then prevailing lower prices available on foreign steel products. The company struck a balance between its two goals by purchasing approximately one-half of the necessary pipe from domestic steel companies from whom prompt delivery could be expected, with the remainder to be purchased from less accessible but more economically attractive foreign manufacturers. The management personnel at Lone Star were unskilled in international transactions and it was determined that the company would seek quotations from brokers and suppliers of foreign steel products.

The Crispin Company supplied a quotation under which it would obtain pipe manufactured to Lone Star's unique specifications from European manufacturers and would deliver it to Lone Star in Houston, Texas. Crispin supplemented this proposal with another in which it would assume the additional responsibility of coating the pipe with anti-corrosive agents and transporting it to the Lone Star job sites. In time, on June 9, 1972, a contract between Lone Star and Crispin was executed, titled a "Sales Contract for High-Test Line Pipe And Transportation Agreement." The contract differed substantially from the proposals initially submitted by Crispin.

Under the terms of the contract, Crispin was the seller of the pipe and Lone Star the buyer. The contract specifically called for title to the pipe to pass from Crispin to Lone Star at the mills in Europe. Separate provisions called for Crispin to be responsible for transporting the

pipe from the mills in France and Italy to a debarkation port in Europe; for shipping the pipe from Europe to Houston; for unloading the ships and storing the pipe in a Houston dockyard storage area; and for transporting the pipe from the storage area to a commercial pipe treatment facility. Separate consideration was stated in the contract for the purchase price of the pipe and for the transportation charges. These were to be paid by Lone Star after delivery of the pipe in Houston. Crispin assumed the risks of loss during transportation and agreed to hold Lone Star harmless for any casualties during transit. Lone Star retained the right to inspect the pipe at any phase of manufacturing and shipment, and to reject defective or damaged portions. Lone Star also retained the right to cancel the contract if and when the delivery schedule for the pipe was not met, subject to its ability to obtain the pipe from another source for earlier delivery.

With only minor deviations, the purchase and transportation of the pipe was completed pursuant to the terms of the contract. Upon arrival at Houston, the various shiploads of pipe were offloaded and stored at the Ramsey Storage Yard at the port. The amount of time a particular shipload of pipe remained at the storage yard varied. Some pipe remained in storage for no more than six days, while other pipe remained for more than sixty days. Most of the pipe was moved from storage to the Surfcote Coating Corporation plant in Houston, where it was given anti-corrosion treatment before being moved to the job sites in West Texas. A small portion of the pipe was transferred directly from storage to the job sites and was coated there. Line X was completed in June, 1973, and in September, 1973, the Railroad

Commission issued Lone Star a permit to operate the pipeline. Lone Star, without protest, paid state use taxes on the pipe in the amount of $670,886.29. The Comptroller later conducted an audit of the company and assessed a local use tax of $138,216.23. Lone Star paid the local tax under protest and filed a claim for refund of both the state and local taxes. The Comptroller denied the claim for refund and Lone Star brought this action.

The applicable statutory provisions, Article 20.01, et seq.,[1] are, with italics added, as follows:

Art. 20.01 Title - Definitions

This Chapter is known and may be cited as the "*Limited Sales, Excise and Use Tax Act,*" and the following words shall have the following meanings unless a different meaning clearly appears from the context:

. . .

(K) Sale.

(1) (a) "Sale" means and includes any transfer of title or possession, or segregation in contemplation of transfer of title or possession, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration.

. . .

(N) Storage. "Storage" includes any keeping or retention in this State for any purpose *except* sale in the regular course of business or subsequent use

1. Title 122A, Taxation-General, 20A, TEX. REV. CIV. STAT. ANN. (1969). Unless otherwise indicated, all statutory references hereafter will be to articles and sections of this Act.

solely outside this State of tangible personal property purchased from a retailer.

(O) Storage and Use Exclusion. "Storage" and "Use" do not include the keeping, retaining or exercising of any right or power over tangible personal property for the purpose of subsequently transporting it outside the State for use thereafter solely outside the State, or for the purpose of being processed, fabricated or manufactured into, attached to, or incorporated into, other tangible personal property to be transported outside the State, and thereafter used solely outside the State.

. . .

(R) Use. "Use" *includes* the exercise of any right or power over tangible personal property incident to the ownership of that tangible personal property except that it does not include the sale of that tangible personal property in the regular course of business or the transfer of tangible personal property as an integral part of a taxable service rendered in the regular course of business. "Use" specifically includes the incorporation of tangible personal property into real estate or into improvements upon real estate without regard to the fact that such real estate and improvements may subsequently be sold as such except as provided in Article 20.01 (T)(2).

. . .

Art. 20.02 Imposition of Limited Sales Tax

There is hereby imposed a limited sales tax at the rate of four per cent (4%) on the receipts from the sale at retail of all taxable items within this State.

Art. 20.03 Imposition and Rate of Use Tax

An excise tax is hereby imposed *on the storage, use or other consumption* in this State of taxable

items purchased, leased or rented from any retailer *for storage, use or other consumption* in this State, at the same percentage rate as is provided in Article 20.02 of this Title, on the sales price of the taxable item, or in the case of leases or rentals, on said lease or rental prices.

Art. 20.04 Exemptions

. . .

(G) Interstate Shipments.

. . .

(3) Special *Use Tax* Exemption. The use tax imposed herein shall not apply to:

(a) The *use,* in this State, of tangible personal property which is acquired outside this State and which is moved into this State for use as a licensed and certificated carrier of persons or property.

(b) The temporary *storage* in this State of tangible personal property which is acquired outside this State and which, subsequent to being brought into this State and *stored here temporarily, is used solely outside this State* or is physically attached to or incorporated into other tangible personal property which is *used solely outside this State.*

(c) The *storage, use or consumption* of tangible personal property which is acquired outside this State, the sale, lease or rental *or* the storage, use or consumption of which tangible personal property would be exempt from the limited sales or use tax were it purchased within this State.

(d) The *storage and use,* in this State, of tangible personal property acquired outside this State for use as a repair or replacement part for and actually affixed in this State to a self-propelled

vehicle which is a licensed and certificated common carrier of persons or property.

. . .

(K) *Use Tax* Inapplicable When Limited Sales Tax Applies or When Use Tax Previously Paid. The *storage, use or other consumption* in this State of taxable items, the receipts from the sale, lease, rental or use of which are required to be included in the measure of the limited sales tax, or taxable items upon which a use tax has been paid by the taxpayer using said taxable items, is exempted from the *use tax* imposed by this Chapter.

. . .

The Comptroller contends that the pipe transaction in question subjected Lone Star to the imposition of the State and local taxes upon each of these statutory bases: as a *Sale* of the pipe under Arts. 20.02 and 20.01(K); as a *Use* of the pipe under Arts. 20.03 and 20.01(R); and as a *Storage* of the pipe under Arts. 20.03 and 20.01(N). Lone Star contends, on the other hand, that there is not a taxable event in either statutory instance. As we understand, Lone Star does not deny that there was a storage and a use of the pipe in Texas within the terms of Arts. 20.01(N) and 20.01(R); its position is that, notwithstanding, the use tax exemption of Art. 20.04(G)(3)(a) is applicable alike to the use and to the storage of the pipe and exempts Lone Star from liability for a tax on either event. We hold that the Act imposes a separate tax on the use and on the storage of items, and that the Art. 20.04(G)(3)(a) exemption is inapplicable to the storage tax. This holding renders unnecessary consideration of the question of whether Lone Star is a licensed and certificated carrier of persons

or property within the terms of the exemption, as well as whether there was a taxable sale in Texas.

Art. 20.03 imposes a tax on (1) the use of property, (2) the storage of property, and (3) the other consumption of property. These taxes are collectively called the Use Tax. Thus, when the Legislature speaks of the Use Tax, it refers not only to the tax on the use of property but also to the tax on storage and the tax on other consumption. It is clear from this that the exemptions provided in subsections (a) through (d) of Art. 20.04 (G) have definite meaning and are not "nullities" as argued by Lone Star. Subsection (a) exempts the "use" of certain property from the general "Use Tax." It does not exempt the storage or other consumption of property from the tax imposed on these activities by the "Use Tax." Likewise, subsection (b) exempts only temporary "storage" from the "Use Tax." No exemption is provided in this subsection for the use or "other consumption of property." Significantly, when the Legislature intended to exempt all of the activities taxed by the "Use Tax," it specifically stated that the (1) use, (2) storage, and (3) other consumption of a certain type of property would be exempt from the "Use Tax." See Art. 20.04(G)(3)(c).

The tax on the storage, use or other consumption of property, generically known as the Use Tax, is designed to complement the Sales Tax imposed by Article 20.02 on "the receipts from the sale at retail of all taxable items within this State." The Sales Tax, by definition, can only reach those transactions which occur in this State. A tax upon the sale of items in another state would constitute an unconstitutional burden on interstate commerce. See, *McLeod v. J. F. Dilworth Co.*, 322 U.S. 327 (1944).

If the Sales Tax had been enacted without the complementary Use Tax, the burden of contributing to the support of the government in this form of taxation would have fallen upon those consumers who purchased goods in this State. The purpose of the Use Tax, then, is to more evenly distribute the tax burden among all consumers by imposing a tax on the fruits of an interstate purchase as well as on the sale of property in the State. See *United Air Lines v. Mahin*, 410 U.S. 623, 638 (1973); *American Airlines, Inc. v. State Board of Equalization*, 30 Cal. Reptr. 591 (Dist. Ct. App. 1963).

In order to serve this purpose, the Use Tax includes a tax not only on the use of property but also on the storage of property. Most commonly the storage tax is imposed on property that is purchased in another jurisdiction, and is, therefore, not subject to state taxation; and which is thereafter used as part of an interstate commerce activity, also not a proper subject for state taxation. In *Southern Pacific Co. v. Gallagher*, 306 U.S. 167 (1939), the United States Supreme Court held that the tax on storage could be validly imposed by the State of California on that "taxable moment when the former [goods purchased outside the state] had reached the end of their interstate transportation and had not begun to be consumed in interstate operation." 306 U.S. at 177. See also, *Pacific Telephone and Telegraph Co. v. Gallagher*, 306 U.S. 182 (1939); *Northern Natural Gas Co. v. Lauterbach*, 100 N.W.2d 908 (Iowa 1960); and *American Airlines, Inc. v. State Board of Equalization, supra*. The same reasoning is applicable here, where the pipe in question had reached the end of its international transportation and had not begun to be consumed in an activity claimed to be exempt from the tax on use.

The question of the liability of Lone Star for local sales and use taxes is controlled by what we have hereinabove held with respect to Art. 20.01, et seq. The Local Sales and Use Tax Act, Art. 1066c, TEX. REV. CIV. STAT. ANN. (Supp. 1978), imposes a tax on the storage of property concurrently with the imposition of the tax under Art. 20.01, et seq. Our holding that Lone Star is liable for the State Use Tax on the storage of the pipe renders Lone Star also liable for the local tax.

Accordingly, the judgments of the courts below are reversed and judgment is here rendered that Lone Star take nothing in its suit.

Zollie Steakley
Justice

OPINION DELIVERED: June 7, 1978.

APPENDIX B

AFFIRMED NOVEMBER 17, 1977

Trial Court
241,072

NO. 5770

IN THE
COURT OF CIVIL APPEALS
FOR THE
TENTH SUPREME JUDICIAL DISTRICT OF TEXAS
AT WACO

* * * * * *

BOB BULLOCK, COMPTROLLER OF
PUBLIC ACCOUNTS, ET AL,
Appellants

v.

LONE STAR GAS COMPANY, A Division
Of Enserch Corporation,
Appellee

* * * * * *

From 200th Judicial District Court,
Travis County, Texas

* * * * * *

OPINION

* * *

This is a suit for refund of taxes under the Limited Sales Excise and Use Tax Act. The taxes were paid

under protest by Plaintiff-Appellee Lone Star Gas Company pursuant to Article 20.10(G) and (H), Taxation-General, Volume 20A, Vernon's Texas Civil Statutes. Thereafter, Lone Star brought this suit in a District Court of Travis County, Texas, for refund of such taxes against Defendant-Appellants Bob Bullock, Comptroller of Public Accounts, Jesse James, State Treasurer, John L. Hill, Attorney-General of Texas, and the State of Texas.

Trial was had to the court without a jury, after which the trial court awarded judgment in favor of Lone Star against the Defendants for said taxes paid by Lone Star in the amount of $809,102.52 plus interest, from which the Defendants appeal.

We affirm.

No findings of fact and/or conclusions of law were requested of or made by the trial court.

Defendant-Appellants assert error on the part of the trial court in holding: (1) that for sales tax purposes the sale of pipe took place outside the State of Texas; (2) that the use tax was unlawfully imposed on the storage of pipe after it arrived in the State of Texas and before it was assembled and used as a carrier; and (3) that Lone Star as a permit carrier was a "licensed and certificated carrier" and therefore exempted from the use tax by Article 20.04(G)(3)(a), Taxation-General, Vol. 20A, V.T.C.S. We overrule all of Defendant-Appellants' contentions and affirm the trial court's judgment. Our view of the case is bottomed upon two premises, to wit: (1) that the sale of the pipe in question took place in Europe and not within the State of Texas, to the end that the pipe was not subject to the sales tax; and (2)

that Lone Star at the times material to this lawsuit was a "licensed and certificated carrier" within the meaning of Article 20.04(G)(3)(a), Taxation-General, Vol. 20A, V.T.C.S., so that the pipe was exempted from the use tax.

The pertinent facts are these: Lone Star is a Texas Corporation, having its principal place of business in Dallas, Texas, and is engaged in the business of gathering, transporting, and selling natural gas. Pursuant to its business, Lone Star holds permit Number 00578 from the Railroad Commission of the State of Texas. In the early part of 1972, Lone Star determined to construct an intrastate pipeline from the Delaware Basin in Pecos County, Texas, to Dallas County, Texas, which pipeline is designated "Line X," and is a 36 inch diameter pipeline about 442 miles long. The pipe weighs 141 pounds per foot. Lone Star purchased from domestic producers enough pipe for about the first 200 miles of Line X to be constructed, and this pipe is not in controversy here.

The pipe in controversy is that which was purchased by Lone Star to construct the remaining 242 miles of the pipeline which was bought by Lone Star from the Crispin Corporation under a written contract.

Crispin is a Texas Corporation with its principal place of business in Houston, Texas. Its major business activity is brokering foreign steel products. Crispin's normal business procedure is to locate a buyer, then through its overseas contacts to arrange production of the buyer's order. It does not maintain an inventory of steel products, particularly of the size pipe in question, nor does it purchase such large pipe for its own account. Its assets consist of familiarity of European steel pro-

ducers, their languages, production methods and schedules, and shipping resources.

The contract between Lone Star and Crispin was signed in July 1972. Pursuant to the contract, Crispin caused the pipe to be manufactured by firms located in France and Italy, bought the pipe from these foreign mills, and sold it to Lone Star for a profit. This pipe had to be specially constructed in order to meet the unique needs of Lone Star for Line X; therefore, by the contract Lone Star provided to Crispin a complete list of specifications, including the chemical properties of the steel from which the pipe was to be produced, the type of steel furnace in which the iron was to be made, inspection of the method for rolling the steel into flat plates prior to manufacture of the pipe, inspection of the flat plates, specification of the method of rolling the flat plates into finished pipe, the weld method for joining the flat plate into the finished pipe, the various physical properties of the pipe, procedures for loading the pipe on rail cars in Europe, procedures for storing the pipe in ships for shipment to the United States, and procedures for shipment of the pipe to the final destination point. Production was a three stage process: (1) the steel was produced, (2) the flat plate was rolled from the steel, and (3) the pipe was manufactured from the flat plate. Steel mills throughout Europe were used in the manufacturing process. The pipe was manufactured by a French firm at plants located in Dunkirk, Sedan, and Belleville in France, and by an Italian firm whose plant was located near Taranto, Italy.

Moody International, an independent inspection firm, was employed by Lone Star to monitor and conduct

inspections at every critical phase of the contract from the production of the flat plates through the manufacture of the pipe, then at the phase of loading the pipe from the steel mills to the ships, the loading upon the ships, the transportation by the ships, the unloading of the ships, and then to Ramsey's Storage Yard near the dock site at Houston, Texas. To be more specific, the contract provided that Moody would conduct five inspections: the first when the steel was rolled into flat plates before the pipe was made, and the last after the pipe was in the ground as a pipeline. Lone Star had the right to reject (and did reject) the material at any time, from the date the plate was rolled (in Europe) until the pipeline was operational (in Texas). Lone Star by and through its independent inspection agents did inspect and reject pipe at every phase of the entire operation contemplated and covered by the contract, from the mills in Europe to the operational pipeline in Texas. These rejections caused delays and expense to Crispin and to the manufacturers concerned.

Crispin was responsible for the transportation of the pipe from the European steel mills by rail and water to Houston, Texas, and from there to the final transportation point near Houston. The contract required Crispin to carry insurance payable to Lone Star during this transportation phase.

The contract provided that title of the pipe would pass from Crispin to Lone Star when the pipe was loaded on the railroad carrier at the mill, that is to say, "FOB mill," which was in Europe. The pipe was stencilled at the mill and there identified to the contract.

The shipments were made pursuant to the contract from August 1972 through December 1972, and in all 1.28 million feet (or approximately 242 miles) of pipe were invoiced and delivered to Lone Star. After the pipe arrived at the port of Houston, Texas, it was first taken to Ramsey's Storage Yard near the docksite and then to a place in or near Houston operated by a firm called "Surfcote," which firm coated the exterior and interior of the pipe to protect the pipe from corrosion after it was placed in the ground. The pipe was thereafter loaded upon Lone Star's trucks and directed to one of six pipe-laying spreads on Lone Star's right-of-way in West Texas. After all the pipe had been laid, it was subjected to a hydrostatic test for checking against leaks. At this stage there were three failures of the foreign pipe, the expense for all of which were paid by the companies responsible.

Subsequent to the completion of Pipeline X, Lone Star was audited by the State Comptroller of Public Accounts, after which Lone Star was assessed the taxes in question. Lone Star paid these assessed taxes under protest, and thereafter made a claim for refund which was denied. Then after exhausting its administrative remedies, Lone Star filed suit in a District Court of Travis County, Texas, for refund of the taxes paid, which resulted in the judgment in favor of Lone Star for recovery of the taxes paid.

Appellants' points of error oblige us to deal with these basic questions:

(1) Was the pipe subject to the sales tax, as a sale of taxable items within this State?

(2) If the pipe was not subject to the sales tax, then was it subject to the use tax, or was it exempted from the use tax under Article 20.04(G)(3)(a), on the basis that Lone Star was a "licensed and certificated carrier"?

(3) If the pipe was not subject to the sales tax, was it nevertheless subject to the use tax by virtue of its "storage" in Texas before it was put into the pipeline, even if Lone Star is a "licensed and certificated carrier"?

We revert to the first question, that is, was the pipe subject to the sales tax, as a sale of taxable items within this State. We are of the opinion and hold that the pipe was not subject to the sales tax.

Article 20.02, Taxation-General, V.T.C.S., provides:

"There is hereby imposed a limited sales tax at the rate of four per cent (4%) on the receipts from the *sale at retail of all taxable items within this State.*" (emphasis supplied).

Article 20.01(K) provides in its pertinent parts:

"(1)(a) 'Sale' means and includes any transfer of title or possession, or segregation in contemplation of transfer of title or possession, . . . in any manner or by any means whatsoever, of tangible personal property for a consideration."

"(2) 'Sale' includes: . . .

"(e) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer."

The contract specifically provides that title to the pipe passed from Crispin as Seller to Lone Star as Buyer at the steel mills where produced, all of which were in Europe, and none of which were "within this State." The parties had the right to explicitly agree on the manner and conditions under which title would pass, and they did so. See Article 2.401(a), Texas Business and Commerce Code, V.T.C.S.; *Day and Zimmerman v. Calvert* (Tex. 1975) 519 S.W.2d 106, 110.

The definition of the term "sale" as hereinabove quoted, speaks of a transfer of title or possession, or a segregation in contemplation of a transfer of title or possession. This pipe was "segregated" at the mills because it was specially manufactured for Lone Star and each pipe was stencilled there to identify it for Lone Star.

Our Supreme Court has held that when materials are loaded upon trucks of a common carrier or other means of transportation, a "segregation in contemplation of transfer of title or possession" occurred and a sale takes place between the vendor and vendee under the provisions of the Limited Sales, Excise, and Use Tax Act. *Gifford-Hill and Co. v. State* (Tex. 1969) 442 S.W.2d 320, 323; *Day and Zimmerman v. Calvert* (Tex. 1975) 519 S.W.2d 106, 110.

Appellants argue that the pipe is subject to the sales tax on the theory that there was a "transfer of possession" of the pipe at Houston, Texas, from Crispin to Lone Star. The holdings in *Gifford-Hill* and in *Day and Zimmerman* in our view foreclose this argument. Moreover, although Crispin was responsible for the transportation of the pipe from the European mills to Houston, Texas; yet during all those times the pipe was subject to the control of Lone Star by virtue of its inspections. In other words,

during these times Crispin was acting as a bailee of the pipe holding possession for the benefit of the bailor and owner, Lone Star. This is further borne out in that the contract provided that Crispin insure the pipe during this phase for the benefit of and payable to Lone Star. For these reasons, we believe and hold that the pipe was not subject to the sales tax.

We now pass to the second question, and that is: Was the pipe subject to the use tax, or was it exempted from the use tax under Article 20.04(G)(3)(a), on the basis that Lone Star was a "licensed and certificated carrier"? We are of the opinion and hold that under this record Lone Star was a "licensed and certificated carrier" and therefore the pipe was exempted from the State use tax.

Article 20.03, Taxation-General, V.T.C.S. in its pertinent parts provides:

"An excise tax is hereby imposed on the storage, use or other consumption in this State of taxable items purchased, . . . from any retailer for storage, use or other consumption in this State, at the same percentage rate as is provided in Article 20.02 of this Title, on the sales price of the taxable item . . ."

"Storage" is defined in Article 20.01(N) as follows:

" 'Storage' includes any keeping or retention in this State for any purpose except sale in the regular course of business or subsequent use solely outside this State of tangible personal property purchased from a retailer."

Article 20.01(R) in its pertinent parts defines "use" as follows:

" 'Use' includes the exercise of any right or power over tangible personal property incident to the ownership of

that tangible personal property except that it does not include the sale of that tangible personal property in the regular course of business or the transfer of tangible personal property as an integral part of a taxable service rendered in the regular course of business. 'Use' specifically includes the incorporation of tangible personal property into real estate or into improvements upon real estate . . ."

Article 20.04(G)(3)(a) provides for an exemption to the use tax as follows:

"(3) Special Use Tax Exemption. The use tax imposed herein shall not apply to:

"(a) The use, in this State, of tangible personal property which is acquired outside this State and which is moved into this State for use as a licensed and certificated carrier of persons or property."

In the case at bar, Lone Star was the holder of a permit from the Railroad Commission of Texas for the operation of gas pipelines, which included "Line X."

Appellants contend that Lone Star's "permit" is not to be construed as to be included as a "license" or "certificate" so as to entitle Lone Star to be a "licensed and certificated carrier" within the meaning of Art. 20.04 (G)(3)(a). We do not agree. Our Supreme Court has held that the term "permit" is synonymous with the term "license." *Motl v. Boyd* (Tex. 1926) 116 Tex. 82, 286 S.W. 458, at p. 475. Also see *Ex Parte Truelock* (Court of Crim. Appeals 1940) 140 S.W.2d 167, at p. 174. We therefore believe and hold that the pipe in question was exempted from the use tax under Article 20.04(G) (3)(a).

Finally, Appellants contend that even though Lone Star was a licensed and certificated carrier, that the pipe was subject to the use tax because it was "stored" in Texas after it arrived in Texas and before it was used as part of the pipeline. We do not agree. The proof showed that the pipe was stored in Texas at varying periods not less than six days nor more than sixty-nine days before being laid in the ground as a pipeline. It is undisputed that the pipe was intended for use as a gas pipeline (Line X) at all times material to this controversy, and for no other use, including the time it was stored in Texas preparatory to being made into the pipeline. To hold that the pipe was subject to the use tax during the storage phase would render the exemption under Article 20.04 (G)(3)(a) meaningless and would, we believe, be a misconstruction of this exemption statute.

We have given careful attention to and consideration of all of Appellants' points and contentions, and overrule all of same as being without merit. Judgment of the trial court is accordingly affirmed.

AFFIRMED.

JOHN A. JAMES, JR.
Associate Justice

Attorneys for Appellants:
John L. Hill, Attorney General
Martha E. Smiley, Asst. Atty. Gen.
Austin, Texas

Attorney for Appellee:
Michael L. Cook
Clark, Thomas, Winters & Shapiro
Austin, Texas

APPENDIX C

No. 241,077

IN THE 53RD DISTRICT COURT OF
TRAVIS COUNTY, TEXAS

LONE STAR GAS COMPANY,
A Division of Enserch Corporation

v.

BOB BULLOCK, COMPTROLLER OF
PUBLIC ACCOUNTS
THE STATE OF TEXAS

JUDGMENT OF THE COURT

On the 22nd day of November, 1976, came on to be heard the above cause. The Plaintiff, Lone Star Gas Company, A Division of Enserch Corporation, appearing through its attorney, and the Defendant Bob Bullock, Comptroller of Public Accounts of the State of Texas, appearing through the Attorney General of Texas, announced ready for trial. No jury having been demanded, the Court proceeded to hear the pleadings, evidence and arguments of counsel, and the Court finds that the law and the facts are with the Plaintiff, Lone Star Gas Company, A Division of Enserch Corporation, and against the Defendant Bob Bullock, Comptroller of Public Accounts of the State of Texas, and that said Plaintiff should have and recover of and from the Defendant Bob Bullock, Comptroller of Public Accounts of the State of Texas the sum of Eight Hundred Nine Thousand One Hundred Two and 52/100 Dollars ($809,102.52) together with interest at the rate of six percent (6%) per annum, such amount being the same as Plaintiff's claim for refund which was denied by the Defendant.

It is therefore, ORDERED, ADJUDGED, AND DECREED by the Court on this _____ day of January, 1977, that Plaintiff, Lone Star Gas Company, A Division of Enserch Corporation, do have and recover of and from the Defendant Bob Bullock, Comptroller of Public Accounts of the State of Texas the sum of Eight Hundred Nine Thousand One Hundred Two and 52/100 Dollars ($809,102.52) with interest at 6% per annum from the respective dates of payment as follows:

October 31, 1972	$220.184.82
January 31, 1973	$450,716.02 (less refund of $14.55 paid by defendant on April 30, 1973)
October 17, 1975	$138,216.23

until paid, together with all costs of suit, for which execution issues.

DONE, SIGNED AND ENTERED OF RECORD this _____ day of January, 1977.

_____
HERMAN JONES
Presiding Judge

APPROVED AS TO FORM
John L. Hill
Attorney General of Texas

Martha Smiley
Assistant Attorney General

By:_____
ATTORNEYS FOR DEFENDANT
CLARK, THOMAS, WINTERS
& SHAPIRO

By: /s/ Michael L. Cook
Michael L. Cook
ATTORNEYS FOR PLAINTIFF

APPENDIX D

EXHIBIT F
Page 1

COMPTROLLER OF PUBLIC ACCOUNTS
STATE OF TEXAS
AUSTIN, TEXAS

DECISION UPON: *Petition for Redetermination*

IN RE: Lone Star Gas Company
301 S. Harwood Street
Dallas, Texas 75201

PERIMT NO.: 1-75-0399066-9
AUDIT NO.: FA 40623
PERIOD: 10-1-70 - 9-30-74
TYPE OF TAX: Sales & Use Tax

HEARING NO.: 6759
HEARING DATE: 5-19-75

Mr. Robert Frederick
PRESIDING HEARINGS EXAMINER

Mr. Philip Cruz, Mr. G. K. Smith,
Mr. Gene Jarman, Attorney
REPRESENTATIVE(S) - FOR PETITIONER

PETITIONER'S CONTENTION

Lone Star Gas Company, Petitioner herein, contends that certain pipe (listed in Comptroller's Audit No. FA 40623-D) is not subject to the tax imposed by the local Sales or Use Tax Act (V.A.T.S., Article 1066c) by virtue of the exemption provided by V.A.T.S., Tax.-Gen., art. 20.04(G)(3)(2). Petitioner had previously paid the state sales tax and has requested a refund of such tax which refund claim is considered in Hearing No. 6799.

REASONS FOR RECOMMENDATION

A sales contract was entered into on June 9, 1972, between The Crispin Company (referred to therein and hereafter as Seller), located in Houston, Texas, and Petitioner (referred to therein and sometimes hereafter as buyer), to convey certain "pipe".

Title to "pipe" vested with buyer upon delivery to the carrier at the production mill (The "mill" is located in Europe), subject to seller's obligations to transport and deliver the pipe to Petitioner at Surfcote Pipe Coating yard, Houston, Texas, where it was internally and externally coated. The Seller was responsible for all arrangements and payments for transportation and delivery of pipe to Houston, Texas on board seller's trucks. Petitioner received and unloaded pipe from seller's trucks at Surfcote Pipe Coating Yard in Houston, Texas. During the course of the coating operation it was determined that the contractor, Surfcote, could not supply coated pipe at the rate required by the laying contract. Therefore 50 miles of bare pipe was shipped directly from the port of Houston to Huckaby, Texas (which does not impose local sales tax). The remainder of the pipe, about 192 miles, was processed through the Houston, Texas coating operating prior to shipment to the construction sites, as originally planned.

V.A.T.S., Tax.-Gen., art. 20.04(G)(3)(2) provides:

> (3) Special Use Tax Exemption. The use tax imposed herein shall not apply to:
>
> (2) The use, in this State, of tangible personal property which is acquired outside this state and which is moved into this State for use as a licensed and certificated carrier of persons or property. . . .

Petitioner is certificated by the Railroad Commission at Texas to operate a pipeline. A certificated pipeline is recognized as a common carrier. *Explorer Pipeline Company v. Calvert,* 126th Judicial District Court, No. 193,423, Austin, Texas, December, 1972. Therefore, if the sale of pipe is not subject to the sales tax, it is not taxable.

Sales tax applies to "the receipts from the sale at retail of all taxable items *within this State.*" (Emphasis Added)

Petitioner claims applicability of the Article 20.04(G)(3)(a) exemption because the sale took place "outside the State" by reason of both the contract of sale and the definition of sale found in Article 20.01(K)(1)(a) which states:

> "Sale means and includes any transfer of title or possession or segregation in contemplation of transfer of title or possession . . ."

Petitioner cites *Gifford-Hill and Company v. State,* 442 S.W.2d 320 (Tex., 1969) and *Day & Zimmerman v. Calvert,* 519 S.W.2d 106 (Tex., 1975) for the proposition that "segregation in contemplation of transfer of title or possession" occurred when the "mill" finished the pipe and placed it on a common carrier in Europe.

All the incidents of sale occurred in Texas including delivery of pipe and payments for the pipe. The Examiner concludes that these together with the existance of a Texas Seller and a Texas Buyer compel a finding of the existence of a Texas sale. See: *Graybar Electric Co., Inc. v. Curry,* 189 So. 186 (Ala. Sup., 1939), affind 30 U.S. 513, 60 S.Ct. 139, reh. den. 308 U.S. 638, 60 S.Ct. 259 and related cases.

V.A.T.S., Art. 1066c provides for the imposition of a local sales and use tax. Section 6 of that Article provides, in part:

> "B.(1) For the purpose of the local sales tax imposed by this Act, all retail sales, leases and rentals, except sales of natural gas or electricity, are consumated at the place of business of the retailer unless the tangible personal property sold, leased, or rented is delivered by the retailer or his agent to an out-of-state destination or to a common carrier for delivery to an out-of-state destination or the taxable service is to be performed at an out-of-state location . . . If the retailer has more than one place of business in the State, the place or places at which retail sales, leases, and rentals are consumated shall be the retailer's place or places where the purchaser or leasee takes possession and removes from the retailer's premises the articles of tangible personal property, or if the retailer delivers the tangible personal property to a point designated by the purchaser or leasee, then the sales, leases, or rentals are consumated at the retailers place or places of business from which tangible personal property is delivered to the purchaser or leasee. . . .

The pipe was delivered within Houston, Texas, where local tax is imposed. The place of business of the retailer from which such sale was made was Houston, Texas. The Examiner concludes that all pipe involved in this decision is subject to the local sales tax.

RECOMMENDATION

The Examiner respectfully recommends that the Deficiency Determination be made final as issued with the balance outstanding shown to be as follows:

STATE

Tax	$ 16,732.80
Penalty	1,699.68
Interest Thru 8-15-75	2,116.50
TOTAL DUE	$ 20,548.98

Interest accrues at $2.75 per day after 8-15-75.

CITY

Tax	$166,764.90
Penalty	16,684.41
Interest Thru 8-15-75	23,746.76
TOTAL DUE	$207,196.07

Interest accrues at $27.41 per day after 8-15-75.

/s/ Robert Frederick
Presiding Hearings Examiner

ORDER OF THE COMPTROLLER

The Recommendations of the Hearing Examiner are approved and adopted in all respects.

It is called to your attention that this order becomes final after the 28th day of September, 1975, and any taxes found to be due together with penalty and interest are due and payable within twenty days thereof. If such taxes are not paid within the time period set forth herein, and additional penalty of ten per cent of the taxes due will accrue, interest will continue to accrue at six per cent per annum, and the bonding or security provisions of Article 20.021(N) will apply.

Given under my hand and in accordance with the provisions of the Limited Sales, Excise and Use Tax Act, this the 29th day of August, 1975.

/s/ Bob Bullock
Bob Bullock
Position COMPTROLLER OF PUBLIC ACCOUNTS

APPENDIX E

CONSTITUTION OF THE UNITED STATES

Section. 8. The Congress shall have Power . . .

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

AMENDMENT [V.]

No person shall be deprived of life, liberty, or property, without due process of law;

AMENDMENT XIV.

Section. 1. All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; or shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Texas Limited Sales, Use and Excise Tax Act

Art. 20.02 Imposition of Limited Sales Tax

There is hereby imposed a limited sales tax at the rate of four per cent (4%) on the receipts from the sale at retail of all taxable items within this State.

Art. 20.03 Imposition and Rate of Use Tax

An excise tax is hereby imposed on the storage, use or other consumption in this State of taxable items purchased, leased or rented from any retailer for storage, use or other consumption in this State, at the same percentage rate as is provided in Article 20.02 of this Title, on the sales price of the taxable item, or in the case of leases or rentals, on said lease or rental prices.

* * *

Art. 20.04

* * *

(G) Interstate Shipments.

* * *

(3) Special Use Tax Exemption. The use tax imposed herein shall not apply to:

(a) The use, in this State, of tangible personal property which is acquired outside this State and which is moved into this State for use as a licensed and certificated carrier of persons or property.

Art. 1066c

Section 2. A. Any city may, by a majority vote of the qualified voters of said city voting at an election held for that purpose, adopt a local sales and use tax for the benefit of such city in accordance with the provisions of this Act.

B. The sales tax portion of any local sales and use tax adopted under this Section is hereby imposed at the

rate of one percent (1%) on the receipts from the sale at retail of all taxable items within any city adopting such tax which items are subject to taxation by the State of Texas under the provisions of the Limited Sales, Excise and Use Tax Act, as enacted, and as heretofore or hereafter amended.

* * *

Section 4. A. In every city where the local sales and use tax has been adopted pursuant to the provisions of this Act, there is hereby imposed an excise tax on the storage, use, or other consumption within such city of tangible personal property purchased, leased, or rented from any retailer on or after the effective date for collection of the sales tax portion of the local sales and use tax for storage, use or other consumption in such city at the rate of one percent (1%) of the sales price of the property or, in the case of leases or rentals, of said lease or rental price; provided, that if no excise tax on the storage, use or other consumption of any article or item of tangible personal property is owed to or collected by the State of Texas under the State Limited Sales, Excise and Use Tax Act, then the tax imposed by this Section shall not be owed to and shall not be collected by for or in behalf of such city for storage or other consumption of such article or item of tangible personal property within such city.

B. In each city where the local sales and use tax has been imposed as provided in Section 2 of this Act, the excise tax imposed under the State Limited Sales, Excise and Use Tax Act on the storage, use, or other consumption of tangible personal property and the excise tax imposed by this Section of this Act shall be added to-

gether to form a combined rate of excise tax which is equal to the sum of the two taxes. The tax imposed by this Section of this Act shall be collected by the Comptroller on behalf of and for the benefit of such city. The bracket system formula prescribed in Subsection K of Section 2 of this Act shall be applicable to the collection of the excise tax imposed under this Section.

Ruling No. 95-0.14 Carriers

Common Carriers. Receipts from the sale of tangible personal property to a common carrier are exempt from the Sales Tax if such property is shipped to a point outside this state by the seller thereof using the purchasing carrier's facilities under a bill of lading, and if such property is to be used by the purchasing carrier in the conduct of its business outside the State of Texas.

Carrier devices such as ships, aircraft, and pipelines, which are acquired outside this state and are moved into this state for use as a licensed and certificated carrier of persons or property, are exempt from the Use Tax. Such carriers are entitled to this exemption only if acquired outside Texas. Repair or replacement parts which are acquired outside this state and actually affixed in this state to a self-propelled vehicle which is a licensed and certificated carrier of persons or property are exempt from the Use Tax. Pipelines, trailers, barges, and semi-trailers are not considered to be self-propelled vehicles.

* * *

Effective September 1, 1975

Ruling .017 Carriers

(1) *Common carriers.* Receipts from the sale of tangible personal property to a common carrier are exempt from the Sales Tax if such property is shipped to a point outside this state by the seller thereof using the purchasing carrier's facilities under a bill of lading, and if such property is to be used by the purchasing carrier in the conduct of its business outside the State of Texas.

Carrier devices such as ships and aircraft, which are acquired outside this state and are moved into this state for use as a licensed and certificated carrier of persons or property, are exempt from the Use Tax. Such carriers are entitled to this exemption only if acquired outside Texas. Repair or replacement parts which are acquired outside this state and actually affixed in this state to a self-propelled vehicle which is a licensed and certificated carrier of persons or property are exempt from the Use Tax. Trailers, barges, and semi-trailers are not considered to be self-propelled vehicles. Taxable items which are to be assembled into carriers are not exempt under the provisions of Article 20.04G(3)(a) as such items are not licensed and certificated carriers when they enter the state.

* * *

Effective December 31, 1975

026.02.20.020. Manufacturing

(1) Persons engaged in the business of manufacturing must collect the sales tax on the sale of their manufactured products in accordance with the provisions of the Limited Sales, Excise and Use Tax Act.

(2) Manufacturing includes every operation commencing with the first production stage of any manufacturing article and ending with the completion of such production. The first production stage is defined to mean the first act of production, and it shall not include those acts in preparation for production.

(3) These are exempted from the taxes imposed by the Limited Sales, Excise and Use Tax Act the sale, production, distribution, lease or rental of and the storage, use or other consumption of gas and electricity when used in manufacturing.

(4) The tax is not imposed on tangible personal property which becomes an ingredient of, or component part of, or is in any manner incorporated into the manufactured product. All materials which are used in any phase of the actual manufacturing, processing or fabricating operation are exempt if they are necessary or essential to the operation. For example, any material which is used to remove impurities, cause a physical or chemical change in a product, or otherwise make the product more marketable is exempt.

* * *

(5) A manufacturer who purchases tangible personal property tax-free by means of an exemption certificate for use as a component part of his manufactured product and subsequently uses the item purchased or his manufactured product for a nonexempt purpose must remit the use tax to the State based on his purchase price of the component part or parts. (Effective Date: December 31, 1975.)

Supreme Court, U. S.
FILED
NOV 2 1978
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

* * *

NO. 78-595

* * *

LONE STAR GAS COMPANY,
A DIVISION OF ENSERCH CORPORATION,
Petitioner

V.

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS, WARREN G. HARDING, STATE TREASURER, AND JOHN L. HILL, ATTORNEY GENERAL OF THE STATE OF TEXAS,
Respondents

* * *

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF TEXAS

* * *

BRIEF FOR RESPONDENTS IN OPPOSITION

* * *

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Attorney General of Texas

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IN THE

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* * *

NO. 78-595

* * *

LONE STAR GAS COMPANY,
A DIVISION OF ENSERCH CORPORATION,
Petitioner

V.

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS, WARREN G. HARDING, STATE TREASURER, AND JOHN L. HILL, ATTORNEY GENERAL OF THE STATE OF TEXAS,
Respondents

* * *

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF TEXAS

* * *

BRIEF FOR RESPONDENTS IN OPPOSITION

* * *

Respondents, Bob Bullock, Comptroller of Public Accounts, Warren G. Harding, successor to Jesse James, State Treasurer and John L. Hill, Attorney General of the State of Texas, respectfully submit the following brief in opposition to the issuance of a writ of certiorari as prayed for by Petitioner.

QUESTIONS PRESENTED

Petitioner presents two questions:

1. Whether state taxing officials may, consistent with the Fourteenth Amendment:

a. promulgate, during the pendency of their suit for tax refund, a regulation legitimizing their position in the lawsuit (reversing earlier regulations favorable to Petitioner) and thus secure a judgment denying a refund based on the retroactive application of the new regulation; and

b. retroactively apply the new regulation only against the Petitioner while admittedly permitting the Petitioner's competitors to receive tax refunds on identical transactions during the same time period.

2. Whether the interpretation of Article 20.04(G)(3)(a) by the Supreme Court of Texas so that only taxpayers purchasing goods outside the State of Texas will be taxed unduly burdens interstate commerce?

Respondent will reply to both questions by showing that:

1. The decision of the Texas Supreme Court was based entirely on state grounds.

2. Petitioner's federal rights were not denied.

3. Petitioner did not adequately preserve its federal questions to invoke the jurisdiction of this Court.

ARGUMENT

1. The decision of the Texas Supreme Court was based entirely on interpretation of the Texas statute.

Article 20.03, Taxation-General, 20A V.T.C.S.,

imposes a Use Tax on the storage, use or consumption of taxable items in the State of Texas. Petitioner contended that the exemption found in Art. 20.04(G)(3)(a) for the "use in this State of tangible property which is acquired outside this State and which is moved into this State for use as a licensed and certificated carrier of persons or property" exempted all taxable events, i.e. storage, use and other consumption of property. The Texas Supreme Court determined that the "use" tax in Texas is imposed on (1) the use of property; (2) the storage of property; and (3) the other consumption of property. It then determined that the exemption in question applied only to "use" and did not include either "storage" or "other consumption" within the State of Texas. It held, therefore, that Lone Star was liable for tax on storage of the pipe within the State of Texas, "where the pipe in question had reached the end of its international transportation and had not begun to be consumed in an activity claimed to be exempt from the tax on use."

The Court did not reach the question of whether pipelines are or should be treated as licensed and certificated carriers. This is the only issue which had related federal questions. In both the Texas Court of Civil Appeals and the Texas Supreme Court, Petitioner claimed that failure to accept its permit as the equivalent of a license or certificate for purposes of the exemption would cause the exemption to operate in an unconstitutional manner. It was only in the context of similar treatment under the exemption for all carriers of persons and/or property that Petitioner claimed a change in administrative policy would operate unfairly. Since the Texas Supreme Court did not reach the issues raised by Petitioner's "licensed and certificated" argument, the Court was not required to and did not reach the question of unequal treatment.

The question of constitutional implications under the

Commerce Clause was not raised. As a result, the Court did not consider the possibility of an undue burden on interstate commerce caused by its decision.

This Court set out the rule for review of state statutes in taxing matters in *Gurley v. Rhoden*, 421 U.S. 200, 208 (1975):

> "... a State's highest court is the federal arbiter of the meaning of state statutes . . ., and therefore our review of the holding of a state court respecting the legal incidence of a state excise tax is guided by the following: 'When a state court has made its own definitive determination as to the operating incidence, our task is simplified. We give this great weight in determining the natural effect of a statute, and if it is consistent with the statute's reasonable interpretation, it will be deemed conclusive.' "

The construction placed on Article 20.04(G)(3)(a) by the Texas Supreme Court is wholly grounded in Texas law without reaching or deciding any federal questions. The construction is entirely consistent with the statutory language. Other sections of the exemption in question excluded from the Use Tax, "temporary storage" Art. 20.04(G)(3)(b), "storage, use or consumption" Art. 20.04(G)(3)(c), "storage and use" Art. 20.04(G)(3)(d). It is clear that the Legislature was aware of the different taxable events included in Use Tax and selectively exempted some of those events under certain circumstances, but did not provide a blanket exemption for all taxable events in section (a). In this instance, even if a federal question had been presented, since the decision of the state court rests solely on an independent and adequate nonfederal ground, this Court would lack jurisdiction to review that decision. *Viator v. Stone*, 336 U.S. 948 (1948). Only the State Supreme Court can

speak with final authority on who bears the tax burden under a state statute. *Boston Chamber of Commerce v. Boston*, 217 U.S. 189, 194 (1910).

2. Petitioner's federal rights were not denied.

Petitioner claims it was denied due process and equal protection by actions of the State Comptroller. Since the taxability of the pipe is based on the non-exempt storage within the state and not whether the pipe is or is not the equivalent of a licensed and certificated carrier, the change in the Comptroller's position on carriers has not harmed Petitioner.

The Court may substitute its judgment for an administrative determination on questions of law. *People v. West Publishing Co.*, 216 P.2d 441, 446 (Cal. 1950); 68 Am. Jur. 2d, Sales and Use Taxes §240 (1973). A regulation which is in conflict with the meaning of a statute as determined by a court must fall. *United States Gypsum Co. v. Green*, 110 So.2d 409, 416 (Fla. 1959); 68 Am. Jur. 2d, Sales and Use Taxes §233. "Due process of law does not assure to a taxpayer the interpretation of state legislation by the executive officers of a state as against its interpretation by the courts of the state or relief from the consequences of a misinterpretation by either." *Thompson v. Kentucky*, 209 U.S. 340, 346 (1908); *Watson v. Kenlick Coal*, 365 F. Supp. 456, 458 (E.D. Ky. 1973; aff'd 498 F.2d 1183, cert. den. 422 U.S. 1012).

There is no evidence that Petitioner was treated differently from other purchasers of pipe in 1975. Petitioner alleges it was treated differently based on Respondents' admission that on other occasions taxpayers were given refunds on use tax previously collected or paid on pipe purchased outside of the State of Texas and moved into the State of Texas for assembly into a licensed and certificated carrier of property. (Tr. 69). There is no evidence that such refunds were made

during the same period of time that Petitioner's request for refund was denied; and there is no evidence that Petitioner was similarly situated with those to whom refunds were granted.

Unless the power of an agency to fashion remedies has been removed, it cannot be concluded that such an agency is denied the power to change its interpretation of the statute. *NLRB v. Seven-Up Co.*, 344 U.S. 344, 352 (1952). In *American Chicle Co. v. United States*, 316 U.S. 450, 455 (1942), the theory that legislative history and "a long indulged administrative construction" made it impossible for the agency to promulgate a regulation comporting with the plain meaning of the statute, was rejected by this Court, even though Congress had reenacted the statute during the interim. *Allstate Construction Co. v. Durkins*, 345 U.S. 13, 16 (1953). This Court had also held that the doctrine of equitable estoppel is not a bar to the correction by an agency of a mistake of law and that such a change could be applied retroactively. *Automobile Club v. C.I.R.*, 353 U.S. 180, 183-184 (1957).

The construction given to the statute by the court does not burden interstate commerce. Petitioner incorrectly stated on p. 11 of its brief that persons who purchase pipe within the State of Texas are not subjected to a sales or a use tax. There is *no exemption* from Sales or Use Tax for the sale of pipe for use within the State. All purchasers of pipe within the State for use in the State pay the State sales tax. Petitioner states no authority for its assertion. A tax on storage after an item has completed its interstate transportation does not violate the Commerce Clause. This Court has established the validity of a tax on storage within a state after the cessation of interstate transportation in *Southern Pacific Co. v. Gallagher*, 306 U.S. 167 (1939). The Texas Court held that such a taxable storage had occurred within the State of Texas after the end of interstate transportation.

3. Petitioner did not adequately preserve its federal question to invoke the jurisdiction of this Court.

To raise a federal constitutional issue under 28 U.S.C. §1257, it must have been raised, preserved and passed upon in the state court below. *Cardinale v. Louisiana*, 394 U.S. 437, 438 (1969); *Tacon v. Arizona*, 410 U.S. 351 (1975). Petitioner pleaded the violation of due process and equal protection guaranteed by the Fourteenth Amendment of the Constitution of the United States and Article I, Sections 3 and 19; Article VIII, Sections 1 and 2 of the Constitution of the State of Texas. Thereafter, Petitioner did not again refer to the Fourteenth Amendment in its Reply Brief to the Third Court of Civil Appeals, see pages 22-24, or its Reply Brief to the Supreme Court of Texas, see pages 12-15. In its Motion for Rehearing, it did not raise any constitutional questions, but requested review based on two points of error:

> I. This court erred in reversing the judgments of the courts below and rendering judgment for Petitioners because there was no basis in the record upon which this court could conclude that a "storage" of the pipe has occurred. Motion for Re-Hearing, p. 1.
>
> II. This court erred in construing Article 20.04(G)(3)(a) not to apply to Lone Star. Motion for Rehearing, p. 5.

Under the second point of error, the entire argument went to the construction placed on the word use. It is well settled that the federal question must be presented to the state courts in such a fashion as to preclude any question that reliance is placed on federal rights as distinguished from rights based on state law. *Gibbes v. Zimmerman*, 290 U.S. 326, 328 (1933). Here all

argument concerning due process and equal protection in the appellate courts of Texas was based on Article I of the Texas Constitution. In *Gibbes, supra*, this Court held that the fact that state and federal constitutions guaranteed the same rights was to no avail.

At no time did Petitioner raise before the Texas courts the possibility of burden on interstate commerce. In fact, in its Motion for Rehearing to the Supreme Court of Texas when discussing *Southern Pacific v. Gallagher, supra*, it states: "Lone Star has never claimed the protection of the federal constitution for its use of the pipe". At p. 9. It is conceded by Respondents that the Motions for Rehearing might have been the first time this issue should have been raised. *Herndon v. Georgia*, 295 U.S. 441 (1935). Failure to raise the issue at any point prevents review by this Court. *C.I.O. v. McAdory*, 325 U.S. 472 (1945).

CONCLUSION

The issues presented before this Court were not adequately preserved for review by this Court. The decision of the Texas Supreme Court is based on a purely state ground. Respondents respectfully request that this Application for Writ of Certiorari be denied.

Respectfully submitted,

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Counsel for Respondents

PROOF OF SERVICE

I hereby depose and say that I am a member of the Bar of the United States Supreme Court and this ____ day of October, 1978, I served three copies of the foregoing Brief in Opposition to Petition for Writ of Certiorari on Petitioner Lone Star Gas Company, by depositing the same in the United States Post Office addressed to the Honorable Michael L. Cook, one of its counsel of record, at his post office address, Post Office Box 1148, Austin, Texas 78767, with Certified, Return Receipt Requested, First Class postage prepaid.

MARTHA E. SMILEY
Assistant Attorney General

APPENDIX

Art. 20.04, Title 122A, Tax.-Gen., 20A V.T.C.S.

(G) Interstate Shipments.

(3) Special Use Tax Exemption. The use tax imposed herein shall not apply to:

(a) The use, in this State, of tangible personal property which is acquired outside this State and which is moved into this State for use as a licensed and certificated carrier of persons or property.

(b) The temporary storage in this State of tangible personal property which is acquired outside this State and which, subsequent to being brought into this State and stored here temporarily, is used solely outside this State or is physically attached to or incorporated into other tangible personal property which is used solely outside this State.

(c) The storage, use or consumption of tangible personal property which is acquired outside this State, the sale, lease or rental or the storage, use or consumption of which tangible personal property would be exempt from the limited sales or use tax were it purchased within this State.

(d) The storage and use, in this State, of tangible personal property acquired outside this State for use as a repair or replacement part for and actually affixed in this State to a self-propelled vehicle which is a licensed and certificated common carrier of persons or property.